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# The Oil Price Crash Puts Apache Corporation In A Tough Spot

Mar. 16, 2020 3:35 AM ET | **APA Corporation (APA)** | 8 Comments | 2 Likes

**Sarfaraz A. Khan**
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## Summary

- Apache Corp. reported guidance-beating production and an adjusted profit of $0.08/share while generating $66 million of free cash flows in the fourth quarter.
- Oil has tumbled to just $32 a barrel, and the commodity's future outlook is looking uncertain.
- The persistent weakness in natural gas and NGL prices, combined with the drop in oil prices, will push Apache's earnings and cash flows lower in 2020.
- Apache has cut its CapEx guidance for 2020 in order to preserve cash flows, although it will still likely burn cash flows.
- The company has the highest debt-to-equity ratio among large-cap independent E&Ps.

**Apache Corp.** (NASDAQ:APA) has reported a better-than-expected profit and free cash flows for the fourth quarter, but the company's earnings will likely drop substantially this year as oil plunges to just $33 a barrel. Apache Corp. was already planning to cut capital expenditures this year, and I think it will likely reduce its spending plans further in light of the latest developments. The company doesn't have a strong balance sheet, which, I think, could weigh on the performance of its shares in 2020.

*Image courtesy of Pixabay*

## Earnings Recap

Apache Corporation has recently released strong results for the fourth quarter, in which it reported better-than-expected profit, strong levels of production, and free cash flows.

The company produced 430,461 boe per day in the fourth quarter on an adjusted basis, up 2% from a year earlier and surpassing the high end of its guidance by 5,000 boe per day. The growth was led in large part by the 22% increase in production (particularly NGL volumes) from the Permian Basin in the US. Apache, however, experienced a tough commodity price environment. Although the company posted a 3.1% increase in average realized price for crude oil, the natural gas and NGL prices fell by 20.2% and 34.9% respectively in the same period. Since natural gas and NGL accounted for 53% of the company's total production in Q4-2019, the weakness in their prices pushed its profits lower.

Apache reported an adjusted profit of $118 million, or $0.08 per share, down from $217 million, or $0.31 per share, a year earlier, but considerably better than analysts' consensus estimate of a loss of $0.05 per share. The company also generated strong levels of cash flow from operations of $820 million (ahead of changes in working cap.), which fully covered upstream capital investments of $590 million as well as $70 million of distributions to non-controlling interest and $94 million of dividend payments. From this, we can see that the company ended the period on a strong note with free cash flows of $66 million. (Apache defines FCF as excess cash flow from operations before working capital changes after upstream capital investment, distributions to non-controlling interest and dividend payments.)

## Looking Ahead

The oil price environment, however, has gotten significantly worse, with the price of the US benchmark WTI crude dropping from more than $60 a barrel at the start of the year to just $33 a barrel at the time of this writing. The mounting fears related to the spread of coronavirus from China to other parts of the world which triggered a reduction in economic activity pushed prices to the low $50s a barrel range in February. Then, earlier this month, oil prices plunged by double digits, falling to as low as $27.34 per barrel, after Russia shot down OPEC's proposal to cut oil production by an additional 1.5 million bpd which prompted Saudi Arabia, the OPEC's kingpin, to launch an all-out price war.

I think the commodity's short-term outlook is also looking bleak considering Saudi Arabia is reportedly planning to flood the market with additional supplies. Saudi Aramco (ARMCO), the kingdom's flagship oil behemoth which has been producing 9.7 million barrels of oil per day, has been asked by the energy ministry to increase its production capacity to 13 million bpd. Furthermore, the spread of coronavirus also threatens to hurt oil demand. As per some reports, the crude oil demand in China has fallen by 3 million bpd, which is roughly equivalent to a third of the country's total demand. We don't know how the virus will impact oil demand in other key markets, particularly the rest of Asia, Europe, and the US. The demand might improve in the summer months, but I think the commodity's future is currently levered to the trajectory of the coronavirus and OPEC's actions.

The prices of natural gas and NGL have already been low for an extended period. This forced Apache to shift capital away from the wet-gas rich Alpine High play which has been driving the company's production growth. Apache also reduced Alpine High's value by $1.4 billion. The persistently weak natural gas and NGL prices also pushed the company's earnings lower, as evident from the latest quarterly results. The significant drop in oil prices will make things even more difficult for Apache. The WTI oil averaged around $57 a barrel last year, but this could drop to just $38.19 per barrel, as per data from the US Energy Information Administration. The company ended last year with an adjusted profit of $2 million and a cash flow deficit of roughly $177 million. Both of these key metrics, which aren't great to begin with, will likely get even worse in 2020. Barring a major uptick in oil prices, the company will likely report losses and cash flow deficits in the upcoming quarters.

Apache was already planning to significantly cut spending in 2020 and increase its focus on producing oil from high-margin assets in the Permian Basin and international markets (Egypt and the North Sea). I expected the company to further cut its CapEx budget in light of the plunge in oil prices, and that's exactly what it is going to do. Apache initially planned to reduce its upstream capital to the range of $1.6-1.9 billion from $2.37 billion last year, depicting a drop of 26% at the mid-point. But now, it expects to spend between $1 billion and $1.2 billion. The company will continue exploring oil in offshore Suriname, where it holds an interest in 1.4 million acres in Block-58. But it will reduce drilling activity substantially elsewhere, particularly in the US, where it will remove all of the drilling rigs. Apache originally expected to deliver a low- to mid-single digit oil growth rate. It also originally forecast total production of 403,000-422,000 boe per day for 2020, including 270,000-285,000 boe per day from the US and the rest from its international business. The guidance depicts flat levels of total production and US production from 2019. But the company will likely announce a new guidance which will show declining levels of production.

Apache has also slashed quarterly dividends to just to $0.025 per share from $0.25 previously. That's going to translate into cash savings of $340 million on an annualized basis. Although these measures will hurt shareholder returns, I think this is a step in the right direction which indicates that the company's current priority is to preserve its cash flows. The company will do that by cutting its cash outflows considerably in an effort to bring them closer to cash inflows from operations. These measures will soften the blow coming from weak oil, gas, and NGL prices, although Apache might still find it difficult to generate enough cash flow from operations to fully fund its CapEx.

I think what puts Apache in a difficult spot is that its financial health isn't great. It has a weak balance sheet marked by high levels of debt, which limits the company's ability to use additional borrowings to fund a cash flow shortfall. At the end of last year, Apache had $8.16 billion of debt (ex. debt associated with Altus Midstream (ALTM)), which translates into a lofty debt-to-equity ratio of almost 250% - the highest among all large-cap independent oil producers, as per my calculations. If the company uses debt to finance some of its CapEx or dividends, for instance by tapping into its revolving credit facility of $4 billion, then it will put more strain on an already stretched balance sheet.

The good thing, however, is that Apache doesn't have any significant (>$500 million) near-term debt maturities. The company has a total of $937 million of near-term debt which becomes due between 2021 and 2023 (notes of $293 million, $463 million, and $181 million). A vast majority of its total debt matures after 2024. I think the company has ample time to devise a plan to shore up its finances, mainly through the sale of non-core assets.

Shares of Apache have fallen by more than 70% this year following the large drop in oil prices which pushed the entire exploration and production space lower. The company might gain some of the lost ground if it announces a major discovery in offshore Suriname. But in a low oil price environment of $30-40 a barrel, it will swing to quarterly losses and will likely burn cash flows. This, combined with a weak balance sheet, could weigh on the performance of Apache stock. I think in a tough oil price environment, investors should play defense by avoiding highly leveraged companies like Apache.

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This article was written by

**Sarfaraz A. Khan**
8.85K Followers

Hey there, I'm Sarfaraz A. Khan - a seasoned financial writer and investor with a passion for uncovering hidden gems. I have a deep understanding of fundamental analysis and I specialize in writing about mid-cap and small-cap compar

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